

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 04-0268
Use Tax and Penalty
For the Years 1998-2000**

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ISSUES

I. Use Tax—Steel Uncoilers

Authority: Ind. Code § 6-2.5-2-1; Ind. Code § 6-2.5-3-1; Ind. Code § 6-2.5-5-3; Ind. Code § 6-8.1-5-1; 45 IAC 2.2-5-8; 45 IAC 15-5-3

Taxpayer protests the assessment of use tax on the purchase of steel uncoilers where no sales tax was paid at the point of purchase.

II. Use Tax--Packaging

Authority: Ind. Code § 6-2.5-5-9; 45 IAC 2.2-5-16

Taxpayer protests the assessment of use tax on the purchasing of packaging paper where no sales tax was paid at the point of purchase.

III. Tax Administration--Negligence Penalty

Authority: Ind. Code § 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the assessment of a negligence penalty.

STATEMENT OF FACTS

Taxpayer is in the business of manufacturing steel tubing. The production process consists of taking flat steel stock and forming, welding, and cutting it into steel tubing. Taxpayer purchased uncoilers, which unroll raw steel from a spool before the steel is loaded into machines that form the flat steel into tubes. Taxpayer paid no sales tax on the purchase of the uncoilers. Taxpayer had protested the same issue to the Department during a prior audit period; the Department denied that protest, and Taxpayer did not appeal that denial.

When shipping the tubing to its customers, Taxpayer uses paper packaging to absorb moisture that would otherwise harm the steel tubing's tensile strength and otherwise protect the steel tubes. Taxpayer paid no sales tax on the paper at the time of purchase. Taxpayer also protests the imposition of a negligence penalty.

Taxpayer supplemented their written protest with a video of their processes, which the Department viewed as part of the protest. Additional facts will be supplied as necessary.

I. Use Tax—Steel Uncoilers

DISCUSSION

Taxpayer protests the proposed assessment of use tax on the purchase of steel uncoilers where no gross retail tax was paid at the point of purchase. Taxpayer argues that the uncoilers perform the first step in the production process.

Pursuant to Ind. Code § 6-8.1-5-1(b) and 45 IAC 15-5-3(8), a “notice of proposed assessment is prima facie evidence that the department’s claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is made.” In general, a person is liable for sales tax at the time of purchase, unless an exemption applies. Ind. Code § 6-2.5-2-1. A parallel tax, the use tax, is also due for any tangible personal property stored, used, or consumed in Indiana. Ind. Code § 6-2.5-3-1. If sales tax was paid at the time of purchase, the amount paid is credited against the use tax. Ind. Code § 6-2.5-3-5. Further, if tangible personal property is purchased for an exempt purpose, the use of that property for the exempt purpose is also exempt from use tax. Ind. Code § 6-2.5-3-4.

Specifically, Ind. Code § 6-2.5-5-3(b) provides that “transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production . . . of other tangible personal property. The applicable regulation, 45 IAC 2.2-5-8, provides in relevant part:

- (a) In general, all purchase of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [45 IAC 2.2] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production.
- (b) The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.
- (c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.
- (d) Pre-production and post production activities. “Direct use in the production process” begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Here, the uncoiler straightened the steel. While this was necessary to begin the process by which Taxpayer produced tangible personal property, the straightening of steel preceded the process in which the steel eventually became steel tubes. As such, the uncoiler did not have an immediate direct effect on the property in production, and thus did not constitute part of the production of other tangible personal property. Taxpayer also raises an argument with respect to the uncoiler being exempt as safety equipment. Taxpayer has not provided sufficient information to substantiate this secondary contention.

FINDING

Taxpayer's protest is denied.

II. Use Tax--Packaging

DISCUSSION

Taxpayer also protests the imposition of use tax for certain paper and cardboard items. In particular, Taxpayer argues that the packaging materials placed in containers to preserve its character during shipping are exempt from tax.

Under Ind. Code § 6-2.5-5-9(d), "[s]ales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds." In addition, 45 IAC 2.2-5-16 provides:

(a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.

(b) In general the gross proceeds from the sale of tangible personal property in a transaction of a retail merchant constituting selling at retail are taxable. This regulation [45 IAC 2.2] provided an exemption for wrapping materials and containers.

(c) General rule. The receipt from a sale by a retail merchant of the following types of tangible personal property are exempt from state gross retail tax:

(1) Nonreturnable containers and wrapping materials including steel strap and shipping pallets to be used by the purchaser as enclosures for selling tangible personal property.

* * *

(d) Application of general rule.

(1) Nonreturnable wrapping material and empty containers. To qualify for this exemption, nonreturnable wrapping materials and empty containers must be used by the purchaser in the following way:

- (A) The purchaser must add contents to the containers purchased; and
- (B) The purchaser must sell the contents added.

* * *

(e) Definitions.

(1) Returnable containers. As used in this regulation [45 IAC 2.2], the term returnable container means containers customarily returned by the buyer of the contents for reuse as containers.

(2) Nonreturnable containers. As used in this regulation [45 IAC 2.2], the term nonreturnable containers means all containers which are not returnable containers.

In this case, the issue was if the protective materials that Taxpayer provided constituted a “container” within the meaning of the statute and regulation. Based on the context of the statute as well as the ordinary definition of the term “container”, the exemption applied to the outer casing or cover of the material, not to the inner packing materials designed to protect the product. Accordingly, Taxpayer has not met its burden and is denied.

FINDING

Taxpayer’s protest is denied.

III. Tax Administration--Negligence Penalty

DISCUSSION

The Department may impose a ten (10) percent negligence penalty. Ind. Code § 6-8.1-10-2.1 and 45 IAC 15-11-2. Taxpayer’s failure to pay the proper amount due as determined by Department audit, generally, will result in penalty assessment. Ind. Code § 6-8.1-10-2.1(a)(3). The Department, however, may waive this penalty if the taxpayer can establish that its failure to file “was due to reasonable cause and not due to negligence.” 45 IAC 15-11-2(c). A taxpayer may demonstrate reasonable cause by showing “that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed....” *Id.*

Even if Taxpayer had been sustained on all issues in its protest, its error percentage would have been reduced from 13.17 percent to six percent of its gross receipts otherwise used to determine the proper amount of use tax. Further, Taxpayer failed to remit use tax on items for which it had previously been assessed tax by the Department, protested, and lost the protest. In light of the circumstances, Taxpayer has not met its burden of showing ordinary business care.

FINDING

Taxpayer’s protest is denied.